

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

PJM Interconnection, LLC:

Docket Nos. ER06-1218-000
ER06-1218-001

ORDER ACCEPTING LONG-TERM TRANSMISSION RIGHTS PROPOSAL,
SUBJECT TO MODIFICATIONS

(Issued November 22, 2006)

I. Summary

1. On July 3, 2006, PJM Interconnection, LLC (PJM) submitted revisions to the Amended and Restated Operating Agreement of PJM (OA) and the PJM Open Access Transmission Tariff (Tariff). The proposed revisions amend the PJM Interchange Energy Market by establishing a Long-Term Transmission Rights (LTTR) product intended to allow load serving entities (LSEs) to hedge their energy market positions on a long-term basis by providing price certainty over the relevant period. PJM states that the purpose of the LTTR proposal is to provide a LTTR product that meets the needs of LSEs in the PJM region in a manner consistent with the requirements of the Energy Policy Act of 2005 (EPAct 2005), the Commission rulemaking,¹ and the existing PJM market design. PJM requests an effective date of March 1, 2007 for the LTTR proposal. In this order, the Commission accepts the proposal, subject to modification.

II. Background

2. PJM, a FERC-approved regional transmission organization (RTO), coordinates the movement of electricity within several eastern states and, as such, is an organized electricity market subject to the Final Rule. The PJM market provides participants with a

¹ See Final Rule on Long-Term Firm Transmission Rights in Organized Electricity Markets, 116 FERC ¶ 61,077 (2006) (Order No. 681, or the Final Rule).

financial hedge against transmission congestion costs in the form of transmission rights. These rights take the form of Financial Transmission Rights (FTRs)² which are obtained through the conversion of Auction Revenue Rights (ARRs) that are allocated to participants annually. PJM currently allocates ARRs in a two-stage process that takes into account the transmission capacity of the grid. FTRs entitle the holder to receive transmission congestion credits that offset transmission charges due to congestion. Under PJM's existing Tariff, in stage 1 of the allocation process, firm transmission service customers nominate sources and sinks for ARRs based on historical usage of their respective transmission zones. In stage 1, ARRs are allocated to each network customer in a zone at levels that are equal to or less than its peak load for that zone including load growth. Stage 2 is a four-round allocation process in which 25 percent of the remaining ARRs are allocated in each round. Transmission customers are able to obtain FTRs by converting ARRs or through periodic auctions of FTRs or through secondary markets.

3. The Commission began looking into the issue of establishing LTTRs in organized electricity markets such as RTOs in 2005. On May 11, 2005, the Commission issued a Notice in Docket No. AD05-7-000 soliciting comments on the implementation of a long-term transmission right in such regions. The notice was issued in recognition of the following facts: 1) congestion costs are an important component of delivered price of electricity; 2) in locational marginal pricing (LMP) markets congestion costs can be hedged with FTRs; 3) at the present time, the longest congestion hedge in all relevant markets is one-year; and 4) transmission customers and other parties had expressed interest in having the ability to obtain longer-term price certainty.

4. On August 8, 2005, EPAct 2005 was signed into law.³ Section 1233 of EPAct 2005 focuses on native load service obligations and, pertinent to this filing, section 1233(a) amends Part II of the Federal Power Act (FPA)⁴ by adding section 217, which addresses rights and obligations related to native load service obligations. Section 217(b)(4) directs the Commission to use its authority to facilitate transmission planning and expansion to meet the reasonable needs of LSEs with respect to meeting their service obligations and, relevant to this filing, securing LTTRs for long term supply arrangements made, or planned, to meet such obligations. Section 1233(b) of the EPAct 2005 directs the Commission to implement section 217(b)(4) by rule or order.

² While "FTR" is sometimes used to refer to "firm transmission right," the Final Rule uses the acronym to refer to the various forms of financial transmission rights that exist in organized electricity markets. The PJM market uses the term "financial transmission right."

³ Pub. L. No. 109-58; 119 Stat. 983-84 (2005).

⁴ 16 U.S.C. § 824 *et seq.* (2000).

5. Thus, pursuant to section 1233(b) of the EAct 2005, on February 2, 2006, the Commission issued a notice of proposed rulemaking (NOPR) that would require transmission organizations to implement LTTR in organized electricity markets. The NOPR proposed to require transmission organizations to provide long-term FTRs in accordance with eight general guidelines, intended to serve as the basis for the substantive framework for the design of LTTR. PJM filed comments generally supporting the NOPR. On July 20, 2006, the Commission issued Order No. 681, the Final Rule on LTTR, in which it adopted seven of the eight guidelines. The Final Rule requires independent transmission organizations that oversee organized electricity markets to make long-term FTRs available to all transmission customers. Transmission organizations subject to Order No. 681 were given 180 days from the date of the Final Rule to make compliance filings regarding LTTR.

III. Filing

6. PJM's LTTR proposal is an extension and modification of its current annual ARR allocation process. The proposal makes changes to the two-stage allocation process by sub-dividing stage 1 into stages 1A and 1B, with 1A being the long-term product. In stage 1A, an LSE may request ARRs for a term covering 10 consecutive PJM planning periods (years) from a subset of historical resources. This LTTR enables historical customers to nominate ARRs equal to or less than their pro-rata share of Zonal Base Load⁵ increased by the projected load growth rate for the relevant zone and up to 50 percent of historical Non-Zone Network Load.⁶ The LSE's load in excess of this defined base load will be unhedged, unless it obtains additional ARRs in subsequent stages of the allocation process. Under stage 1B of the process, LSEs are able to receive up to 100 percent of historical peak load in a manner similar to the quantity available to them in the current stage 1 market.

7. PJM states that the LTTR proposal creates long-term transmission rights based on a priority ten-year ARR allocation for Zonal Base Load that ensures longer term certainty with the flexibility to opt-out of the ten-year rights on an annual basis to accommodate changes in market conditions. PJM states that the proposal creates a link between the

⁵ PJM defines Zonal Base Load as: the lowest daily zonal peak load from the twelve month period ending October 31 of the calendar year immediately preceding the calendar year in which an annual ARR allocation is conducted, increased by the projected load growth rate for the relevant Zone. The definition of Zonal Base Load is in section 1.3.39 PJM's proposed tariff revisions implementing LTTR.

⁶ Section 1.27B defines Non-zone Network Load as network load that is located outside of the PJM Region.

long-term transmission planning process⁷ and the ARR allocation process to ensure the transmission system is upgraded to maintain the feasibility⁸ of stage 1A ARRs for Zonal Base Load plus the projected ten-year growth of base load. PJM adds that the proposal also provides a mechanism for identifying upgrades and the associated costs needed to support requests for thirty-year incremental ARRs, i.e., new ARRs that result from system upgrades. Finally, PJM states that the proposal provides a mechanism to establish new stage 1 resources to cover Zonal Base Load plus the projected ten year growth of Zonal Base Load, and provides for flexibility to replace existing stage 1 resource points with alternate stage 1 resources.

8. PJM's proposed tariff provides that all ARRs, including new stage 1A ARRs, must be simultaneously feasible. If they are not feasible, then the ARRs will be pro-rated and allocated in proportion to the megawatt level requested and in inverse proportion to the effect on the binding constraints using the same methodology (discussed below) as is used under PJM's currently effective Tariff.

9. While PJM filed the LTTR proposal prior to the Commission issuing of the Final Rule, PJM stated that it intended for the filing to comply with the Final Rule. PJM proposes an effective date of March 1, 2007, and requested early Commission action in order to allow PJM and its participants time to prepare for the ARR allocations for the 2007/2008 planning period that commences on June 1, 2007 and for which the nomination process begins after March 1, 2007.

⁷ The PJM transmission planning process, or Regional Transmission Expansion Plan (RTEP), identifies transmission system upgrades and enhancements to provide for the operational, economic, and reliability requirements of PJM customers by integrating transmission, generation, and demand response alternatives. The RTEP process is set forth in schedule 6 of the PJM Operating Agreement.

⁸ Although "feasibility" is not defined in the Final Rule, the Commission made clear its intention that the availability of LTTRs will be subject to feasibility considerations, and that transmission organizations must have adequate planning and expansion policies that incorporate feasibility considerations. *See, e.g.*, P18-21 ("Together, these provisions will ensure that transmission systems are expanded where necessary to ensure the continued feasibility of allocated long-term firm transmission rights, while also giving market participants an explicit right to obtain new incremental transmission rights on a long-term basis, in accordance with prevailing cost allocation methodology in the region.").

IV. Notice of Filing and Responsive Pleadings

10. Notice of PJM's filing was published in the *Federal Register*, 71 Fed. Reg. 40,489 (2006), with comments, interventions and protests due on or before July 17, 2006.

American Municipal Power – Ohio, Inc., Exelon Corporation, Edison Mission Energy, Edison Mission Marketing & Trading, Inc., Midwest Generation EME, LLC, Consumers Energy Company, Pepco Holdings, Inc., Potomac Electric Power Company, Delmarva Power & Light Company, Atlantic City Electric Company, Conectiv Energy Supply, Inc., the PSEG Companies,⁹ Reliant Energy, Inc., Southern Maryland Electric Cooperative, Illinois Municipal Electric Agency, FPL Energy Generators,¹⁰ and H-P Energy Resources LLC filed timely motions to intervene in this proceeding.

11. The Constellation Energy Group Companies¹¹ (Constellation), the NRG Companies¹² (NRG), the Allegheny Energy Companies¹³ (Allegheny), BP Energy Company and the Electric Power Supply Association (EPSA) filed timely motions to intervene and comments in this proceeding.

12. The Long Island Power Authority (LIPA), and the city and towns of Hagerstown, Thurmont, and Williamsport, Maryland (the Maryland Municipalities) filed timely motions to intervene and requested extensions of the comment deadline. Blue Ridge Power Agency (Blue Ridge), and the borough of Chambersburg, Pennsylvania (Chambersburg), filed timely motions to intervene and supported LIPA's request for an extension of time. On July 24th, the Commission granted LIPA's request for an extension of time to file motions to intervene and comments until August 7, 2006.

⁹ Public Service Electric and Gas Company, PSEG Power LLC, and PSEG Energy Resources & Trade LLC.

¹⁰ FPL Energy Marcus Hook, L.P., North Jersey Energy Associates, L.P., Doswell Limited Partnership, Backbone Mountain Windpower LLC, Mill Run Windpower LLC, Somerset Windpower LLC, Meyersdale Windpower LLC, Waymart Wind Farm, LP, and Pennsylvania Windfarms, Inc.

¹¹ Baltimore Gas and Electric Company, Constellation Energy Commodities Group, Inc., Constellation Generation Group, LLC, and Constellation NewEnergy, Inc.

¹² NRG Power Marketing Inc., Conemaugh Power LLC, Indian River Power LLC, Keystone Power LLC, NRG Energy Center Dover LLC, NRG Rockford LLC, NRG Rockford II LLC, and Vienna Power LLC.

¹³ Allegheny Power and Allegheny Energy Supply Company, LLC.

13. Additional motions to intervene were filed by Strategic Energy, LLC, the PPL Parties,¹⁴ Mittal Steel USA, Inc., Old Dominion Electric Cooperative, the Illinois Commerce Commission, and the Delaware Municipal Electric Corporation, Inc. Motions to intervene and comments or protests were filed by LIPA, the Maryland Municipalities, the town of Front Royal, Virginia, Chambersburg, and Allegheny. Dominion Resources Services, Inc. filed a motion to intervene out-of-time.

14. On August 14, 2006, the Commission issued a letter directing PJM to provide additional information within 14 days to assist the Commission in evaluating PJM's LTTR proposal. Specifically, the Commission requested that PJM provide a correlation between PJM's proposed LTTR market rules and the guidelines set out in the Final Rule and to explain in detail how each of the requirements of the Final Rule is satisfied by the proposed LTTR market rules. PJM responded with an informational compliance filing (the compliance filing) on August 28, 2006 in Docket No. ER06-1218-001. Several parties protested PJM's filing: Allegheny, Blue Ridge, Chambersburg jointly with Front Royal, LIPA, and the Maryland Municipalities. In addition, the Pennsylvania Municipal Electric Association (PMEA) filed a motion for leave to intervene out-of-time in the compliance filing subdocket. PMEA generally supports the protests of Chambersburg and Front Royal in these proceedings.

15. The Maryland Municipalities filed a supplemental protest on October 3, 2006, which they later supplemented with prepared testimony of Michael Y. Chechelnitsky. The Maryland Municipalities propose an alternative minimum allocation for ARR's using a "full energy requirements methodology" that would not be subject to pro-rationing. Mr. Chechelnitsky's testimony describes the impact of pro-ration on the Maryland Municipalities and provides technical support for the peak load methodology advocated by the Maryland Municipalities as an alternative to the ARR allocation under PJM's LTTR proposal.

16. On October 11, Chambersburg and Front Royal filed a motion to establish procedures to evaluate the Maryland Municipalities' proposed full energy requirements methodology. Chambersburg and Front Royal assert that critical data and assumptions should be examined, in particular the implications for the Maryland Municipalities' principal supplier, Allegheny. Subsequently, Chambersburg and Front Royal filed a supplemental protest on October 25, which included an affidavit by David V. Downes, setting forth the proposed full energy requirements methodology these parties advocate to be used in lieu of PJM's proposed allocation in stage 1B.

¹⁴ PPL Electric Utilities Corporation, PPL EnergyPlus, LLC, PPL Brunner Island, LLC, PPL Holtwood, LLC, PPL Martins Creek, LLC, PPL Montour, LLC, PPL Susquehanna, LLC, PPL University Park, LLC, and Lower Mount Bethel Energy, LLC.

17. On October 11, PJM filed a motion for leave to file and answer to the protests received on its compliance filing. Chambersburg and Front Royal filed an answer to PJM's answer on October 13. In addition to addressing protests and comments on its compliance filing, PJM addresses the alternative approaches proposed by Maryland Municipalities and supported by Chambersburg and Front Royal. PJM first points out that, in order for its LTTR proposal to be in place for the 2007/2008 planning period, it is necessary to begin implementation as soon as possible, because the ARR allocation process will occur early in March 2007.¹⁵ Thus, if the Commission finds that the alternative proposals merit additional consideration, PJM proposes that the Commission bifurcate this issue and approve the LTTR proposal as filed, subject to the outcome of the further review. This approach will allow the LTTR proposal to proceed while allowing the alternatives proposed by the municipal groups to be given whatever consideration the Commission deems appropriate.

18. On October 19, Allegheny filed a response to Chambersburg's October 11 motion in which it takes no position on the methodology proposed by the Maryland Municipalities but seeks to make clear that it does not "sponsor" the Maryland Municipalities' proposal or request for additional proceedings. Allegheny asserts that the allocation issue raised by the Maryland Municipalities are policy determinations that can be made on the basis of the pleadings in these proceedings.¹⁶

V. Discussion

19. Pursuant to Rule 212 of the Commission's Rules of Practice and Procedure,¹⁷ notices of intervention and timely unopposed motions to intervene serve to make the entities that filed them parties to these proceedings. With respect to motions to intervene out-of-time filed by Dominion and PEMA, the Commission has discretion to grant intervenor status under Rule 214. The Commission will grant these motions, finding that conferring intervenor status for these entities will not prejudice other parties to the proceedings or delay the Commission's decision making. Finally, PJM filed motions to file answers to protests of its LTTR proposal and its compliance filing. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure¹⁸ prohibits an answer to a protest unless otherwise ordered by the decisional authority. The Commission will grant PJM's motions and accept these answers, as they have assisted our decision making.

¹⁵ PJM Answer to Compliance Filing Comments at 19.

¹⁶ Allegheny Answer at 3-4.

¹⁷ 18 C.F.R. § 385.212 (2006).

¹⁸ *Id.* at § 385.213 (a)(2) (2006).

20. The Commission will deny as unnecessary the supplemental protest filed by the Maryland Municipalities, the supplemental protest of Chambersburg and Front Royal, and the latter parties' motion to establish procedures to consider full energy requirements methodologies advocated by each party as alternatives to PJM's proposed procedures for allocating LTTRs. The Commission is approving PJM's LTTR proposal, subject to certain modifications, and does not believe that additional procedures are necessary to address the allocation of LTTRs.

21. The Commission has evaluated the proposed LTTR market in accordance with each of the guidelines of Order No. 681 as discussed below. With two exceptions regarding guidelines (2) and (5), the Commission finds the PJM LTTR proposal to be just and reasonable and not unduly discriminatory and will accept it subject to the outcome of further proceedings as described below. Regarding guideline (2), the Commission finds that PJM needs to develop an uplift mechanism to provide PJM with a source of revenue to make up for shortfalls in congestion revenues. The Commission also finds that PJM has not met its burden under section 205 of the FPA regarding the LSE priority for historical load pursuant to guideline (5) of the Final Rule and establishes a stakeholder process before a settlement judge as described below to develop a revised proposal. In the meantime, PJM's LTTR proposal will be implemented for the 2007/2008 planning period. The Commission reminds PJM that its market rules must also comply with the Commission's order on rehearing of the LTTR Final Rule.¹⁹

22. The Commission received comments and protests that raise concerns about consistency between the guidelines in the Final Rule and PJM's proposal, as well as addressing general concerns about various aspects of the proposal, such as PJM's transmission planning process, transmission rate design and PJM's capacity market design. We will address adherence to the Final Rule guidelines first and will then discuss the general comments.

A. Adherence with Final Rule Guidelines

Guideline (1)

The long-term firm transmission right should be a point-to-point right that specifies a source (injection nodes or node) and sink (withdrawal node or nodes), and a quantity (MW).

23. Guideline (1) is intended to support the ability of LSEs to obtain point-to-point long-term transmission rights that will hedge particular long-term power supply

¹⁹ The Order on Rehearing and Clarification of the Final Rule was issued on November 16, 2006. See 117 FERC ¶ 61,201 (2006).

arrangements. In the Final Rule, the Commission concluded that the primary objective of guideline (1), consistent with FPA section 217(b)(4), is to allow an LSE to obtain a long-term firm transmission right for purposes of hedging congestion charges associated with delivery of power from a long-term power supply arrangement to its load. The Commission expected that guideline (1) would be largely consistent with existing designs already in place in the organized electricity markets operated by transmission organizations.²⁰

PJM's LTTR Proposal

24. PJM states that existing section 7.4.2(a) of the Operating Agreement establishes source, sink and quantity requirements for the stage 1 ARR allocation to Network Service Users²¹ and Qualifying Transmission Customers.²² Network Service Users may request up to peak zonal load and up to its transmission responsibility for Non-Zone Network Load. Qualifying Transmission Customers may request up to the megawatt amount of the firm point-to-point transmission service in place during the historical reference year. Requested stage 1A ARRs are subject to the same source and sink requirements of the existing stage 1 allocation. Network Service Users can nominate stage 1A ARRs in a megawatt amount up to their pro-rata share of the Zonal Base Load, and up to 50 percent of their transmission responsibility for Non-zone Network Load. Qualifying Transmission Customers may nominate up to 50 percent of the megawatt amount the firm point-to-point transmission service in place during the historical reference year. PJM states that the Final Rule clarified that zonal and hub pricing and network points are acceptable transmission rights specification points.

²⁰ Final Rule at P 116.

²¹ Section 1.3.16 of the PJM Tariff defines Network Service User as an entity using Network Transmission Service. Section 1.3.17 defines Network Transmission Service as transmission service provided pursuant to the rates, terms and conditions set forth in Part III of the PJM Tariff, or transmission service comparable to such service provided to an LSE that is also a Transmission Owner.

²² Section 7.4.2(d) of the PJM Tariff defines Qualifying Transmission Customer as any customer with an agreement for Long-Term Point-to-Point Transmission Service, as defined in the PJM Tariff, used to deliver energy from a designated network resource located either outside or within the PJM Region to load located either outside or within the PJM Region, and that was confirmed and in effect during the historical reference year for the zone in which the resource is located.

Comments

25. No comments were filed regarding this guideline.

Commission Determination

26. We find that the PJM proposal complies with guideline (1) of the Final Rule. The proposal provides that the long-term transmission rights be specified by source, sink and megawatt quantity. Stage 1A is essentially an extension of the current PJM practice by which customers nominate ARR's based on historical generation resources and load or delivery points that were in effect during the historical reference year.

Guideline (2)

The long-term firm transmission right must provide a hedge against locational marginal pricing congestion charges or other direct assignment of congestion costs for the period covered and quantity specified. Once allocated, the financial coverage provided by a financial long-term transmission right should not be modified during its term (the "full funding" requirement) except in the case of extraordinary circumstances or through voluntary agreement of both the holder of the right and the transmission organization.

27. Guideline (2) responds to the requirement in FPA section 217(b)(4) that LSEs with service obligations be able to obtain "firm" transmission rights or equivalent financial or tradable rights on a long-term basis. As stated in the Final Rule, we interpreted "firmness" in the context of long-term financial transmission rights to refer primarily to two properties of such rights: stability in the quantity of rights that an LSE is allocated over time; and, "price certainty" for the LSE that seeks to hedge congestion charges associated with a particular generation resource or transmission path by requiring that the rights are fully funded.

PJM's LTTR Proposal

28. PJM states that the LTTR proposal is in compliance with full funding requirement of guideline (2) by providing the firmness of both the quantity and value of stage 1A ARR's. PJM states that the long-term product of stage 1A meets this requirement by linking the simultaneous feasibility of the stage 1A ARR's to the transmission planning and expansion process provided for in Schedule 6 of the Operating Agreement. Under the proposed LTTR, the simultaneous feasibility test for the stage 1A ARR's is conducted annually in the ARR allocation process to assess the feasibility over the ten-year term. If it is determined that the capacity of the transmission system cannot support the stage 1A ARR's at any point in the relevant term, PJM will implement appropriate system upgrades designed to ensure the feasibility of these rights. PJM states that revisions have been

made to RTEP procedures to recognize when transmission upgrades are required to ensure feasibility of rights pursuant to the LTTR market rules.

Comments

29. Allegheny states that PJM's LTTR proposal claims to offer LSEs an opportunity to hedge their energy market positions on a long-term basis by offering price certainty. However, Allegheny states that the proposal offers no assurances that the long-term FTRs that will be allocated by PJM to LSEs will be fully funded and that recent PJM experience demonstrates that there is a significant risk that under funding will occur. According to Allegheny, this risk of FTR under funding that is inherent in the LTTR proposal undermines the long-term price certainty that the proposal claims to provide; and therefore, must be addressed by the Commission. Allegheny states that the Commission should require PJM to collect the revenues needed to make-up any short falls in long-term FTR revenues through an administrative charge that is assessed on all of PJM's long-term firm and network transmission customers.

30. Although the LTTR proposal requires PJM to implement transmission upgrades to ensure the future feasibility of long-term rights, Allegheny states that these long-term rights will continue to be subject to pro-ration and underfunding to the extent that transmission upgrades directed by PJM are not in place on time, do not provide the system capacity expected, or have otherwise been superceded by unforeseen changes in the transmission system. Allegheny states that PJM should be required to develop a backstop mechanism to fully fund allocated long-term transmission rights in the event that PJM ordered transmission upgrades do not come on-line on time or provide the transmission capability that PJM relied upon in allocating the long-term rights.

31. In protests to PJM's compliance filing, Blue Ridge and Chambersburg also challenge PJM's LTTR proposal as inconsistent with the full funding requirement of guideline (2).²³ Blue Ridge cites language from PJM's August 28 compliance filing that "raises the specter that Long-Term FTRs will not be fully funded":

PJM's LTTR proposal is designed to ensure the firmness of stage 1A ARR's both in terms of quantity and value However, if the holder of stage 1A ARR's elects to convert its ARR's to FTR's, the funding of the FTR's is subject to the amount of congestion revenues received by PJM. The intent is to be consistent with the full funding requirement because the LTTR is the stage 1A ARR, which is effectively guaranteed by linking the feasibility thereof to the transmission planning process. Holders of these rights have the option to convert these rights to FTR's, but should

²³ See Blue Ridge protest at 3-6 and Chambersburg protest at 7-8.

be responsible for the potential revenue deficiency that may result from a shortfall in congestion revenues.²⁴

32. Blue Ridge asserts that FTRs arising from stage 1A ARR allocations should be protected to the same extent as the ARRs from which they are derived. Chambersburg agrees and asserts that FTRs are required to be fully funded, too: “Full funding of ARRs is meaningless if there is no way to deal with the revenue shortfalls from congestion once those ARRs are converted.”²⁵ Chambersburg states that the annual feasibility test and resulting potential for pro-ration effectively creates a series of ten one-year ARRs instead of a firm 10-year ARR that could be curtailed during their term. In this regard, Chambersburg states changing circumstances and the risk that transmission upgrades will not be completed may render ARRs not simultaneously feasible. Should this occur, LSEs will be pro-rated despite the requirement that long-term rights should not be modified during its term.

PJM Answer

33. PJM’s October 11 answer asserts that the protestors are incorrect in arguing that its LTTR proposal is inconsistent with guideline (2) because it subjects stage 1A ARRs to a simultaneous feasibility test and, thus, to potential pro-ration. PJM states that LSEs are entitled to use firm transmission rights to the extent necessary to meet a service obligation, subject to a deliverability/feasibility limitation as established in new section 217 of the FPA. According to PJM, the new FPA deliverability criterion is equivalent to PJM’s simultaneous feasibility requirement. PJM states that Congress recognized the physical limitations of the system and did not intend to prohibit transmission providers from limiting LTTRs based on the capacity of the system—the simultaneous feasibility test. Moreover, PJM states that the Final Rule allows substantial latitude to develop structural mitigation to ensure full funding, and PJM argues that this language reflects the Commission’s intention that risks be mitigated but not necessarily eliminated. PJM asserts that this position reflects the physical realities of the transmission grid and the fact that Congress recognized the virtual impossibility of guaranteeing LTTR firmness. Accordingly, Congress placed a deliverability limitation on the new rights created in section 217. PJM points out that several protestors recognize that section 217 does not guarantee a “perfect hedge” against congestion revenues shortfalls.²⁶ PJM concludes that the LTTR proposal’s design structurally mitigates the potential risk to the value and

²⁴ Blue Ridge protest at 4, *citing* PJM compliance filing at 7, n.16.

²⁵ Chambersburg protest at 8.

²⁶ PJM October 11 answer at 4-5.

amount of stage 1A ARR by linking feasibility of stage 1A ARRs and the transmission planning process and is therefore consistent with guideline (2) and section 217 of the FPA.

34. PJM states that project review processes are in place to address protesters concerns that pro-ration may be needed if RTEP upgrades are not implemented in a timely manner or do not result in expected capacity increases, specifically that it has procedures in place in PJM Manual 14C to ensure RTEP projects are completed and placed in-service. In addition, PJM states that the feasibility analysis is performed annually thereby ensuring that transmission capacity upgrades are revised on a rolling basis as needed and that this is superior to the requirements of the Final Rule in that it provides for the resolution of potentially extraordinary circumstances in order to preserve full funding. PJM also states that pro-ration due to unanticipated system changes would be an “extraordinary circumstance,” and therefore revenue shortfalls would be exempt from the full funding requirement.

Commission Determination

35. To meet the full funding requirement of guideline (2) of the Final Rule, the Commission determined that the long-term transmission rights must have two properties: stability in the quantity of rights that a load serving entity is allocated over time and “price certainty” for the load serving entity that seeks to hedge congestion charges associated with a particular generation resource or transmission path.²⁷

36. With regard to stability in the quantity of rights that are awarded, PJM states that this is achieved by linking the simultaneous feasibility of the stage 1A ARRs to the transmission planning and expansion process. Under PJM’s proposal, simultaneous feasibility tests for the stage 1A ARRs are conducted in each annual ARR allocation process. These tests assess the feasibility of the rights prospectively for the ten-year term of the rights, and if it is determined that the capacity of the transmission system cannot support the stage 1A ARRs at any point in the relevant term, PJM states that it will implement appropriate transmission system upgrades designed to ensure the feasibility of these rights.²⁸

37. Allegheny, Blue Ridge and Chambersburg object to the proposal on the grounds that, if necessary upgrades are not completed on time, the stage 1A ARRs could be rendered infeasible. Although we recognize that such a risk exists, we believe that PJM’s proposal to link the simultaneous feasibility of the stage 1A ARRs to the transmission

²⁷ Final Rule at P 170.

²⁸ PJM compliance filing at 7.

planning and expansion process in the manner described minimizes that risk to the extent reasonably practical. Therefore, we find that PJM's proposal satisfies the requirements of guideline (2) with respect to the stability of the quantity of rights awarded.

38. With regard to the concern of Blue Ridge and Chambersburg that the FTRs that are awarded to LTTR holders may be under-funded in the event of a shortfall in congestion revenues, we agree that PJM's proposal does not fully comply with the requirements of guideline (2). Specifically, guideline (2) contemplates that the transmission organization will implement an uplift charge to make up for any shortfall in congestion revenues that would otherwise prevent full funding of the FTRs of LTTR holders.²⁹ However, PJM proposes to continue its existing market rule which is simply to prorate the congestion payments to these FTR holders when congestion revenues are not sufficient for full funding. We recognize that the PJM proposal may be financially equivalent to a procedure that imposes uplift payments on FTR holders that are equal to the holders' reduction in congestion payments. Although we find that the PJM approach to distributing the shortfall can produce an acceptable result, we believe that there are important benefits to achieving that result by means of an uplift mechanism. In particular, by ensuring the full funding of the FTRs held by the recipients of LTTRs, the tradability of the LTTRs is enhanced. Therefore, we will require that PJM modify its proposal within 60 days from the date of this order to include an uplift payment or similar mechanism to provide PJM with a source of revenue to make up for any shortfalls in congestion revenues that would otherwise prevent the full funding of FTRs held by the recipients of LTTRs.

39. With regard to concerns about the need to pro-rate ARR requests due to extraordinary circumstances, the Final Rule limits them to force majeure events and not for system contingencies and other assumptions that were modeled in the simultaneous feasibility test and thereby incorporated into the RTEP process. As discussed below, the Commission is concerned, however, that long-term rights requests may be subject to pro-rating in stage 1A without providing the priority to historical use of the transmission system that was contemplated in EPart 2005 and the Final Rule. Because this issue is intertwined with the historical load priority issue addressed in guideline (5), we will address the issue of pro-rating stage 1A ARR requests in the discussion of guideline (5).

Guideline (3)

Long-term transmission rights made feasible by transmission upgrades or expansions must be available upon request to any party that pays for such upgrades or expansions in accordance with the transmission organization's prevailing cost allocation methods for upgrades or expansions.

²⁹ Final Rule at P 175.

40. The Commission intended that guideline (3) apply to transmission rights awarded to entities that fund transmission upgrades and expansions through direct cost assignment and not to rights related to upgrades that are rolled into transmission rates.

PJM's LTTR Proposal

41. PJM states that it provides incremental ARR to parties that fund certain transmission upgrades or expansions pursuant to Parts II, III, and IV of the PJM Tariff. The Tariff provides a requested amount of incremental ARR in return for any party funding the network upgrades required to create such incremental value. The term of the incremental rights under all relevant sections and parts of the Operating Agreement and Tariff is the lesser of thirty years or the life of the upgrade. PJM states that since the LTTR proposal provides incremental transmission rights to participant-funded projects, it complies with guideline (3).

42. PJM states that while the proposal complies with the Final Rule, section 7.8 will require the establishment of addition processes, rights, and obligations with regard to incremental ARR. PJM states that it will initiate stakeholder discussions to establish rules for parties making requests under section 7.8 that govern queue position, study rights and costs, construction terms and conditions, network upgrade ownership and maintenance, and the timing and calculation of incremental ARR value. PJM states that it will make an additional filing to implement these rules.³⁰

Comments

43. Chambersburg asserts that the LTTR proposal is inconsistent with guideline (3) because it requires the incremental ARR provided for in section 7.8 to be simultaneously feasible. As a result, Chambersburg states that the LSE funding an upgrade that is not simultaneously feasible for a period of time would be left unhedged. In addition, Chambersburg states that LSEs are required to fund incremental network upgrades before they can increase their long-term ARR to return to the fully hedged state prior to pro-rata.

PJM's Answer

44. PJM states that guideline (3) clearly requires simultaneous feasibility in order to protect existing transmission rights and to ensure that the system's capacity can support the Incremental ARR. PJM asserts that both Congress and the Commission recognized the link between transmission rights and transmission capacity. Accordingly, PJM argues

³⁰ LTTR filing at 18.

that only when upgrades produce feasible rights are parties that paid for the upgrades eligible to receive the Incremental ARR³¹.

45. PJM takes issue with Chambersburg's characterizations of the Incremental ARR option provided by proposed section 7.8 as providing inadequate hedging opportunities. PJM points out that the LTTR proposal provides these incremental rights for the benefit of any entity—LSE or other transmission customer—that elects to fund transmission upgrades in exchange for incremental ARRs. PJM agrees with Chambersburg that, if no network upgrades can provide a simultaneously feasible set of desired Incremental ARRs, then those rights cannot be granted under section 7.8 of the proposal. However, PJM asserts that this result is just and reasonable, because it reflects the physical limitations of the transmission system with respect to existing and requested transmission rights, assigns an equitable priority to those rights, and consequently prevents the Incremental ARR option in section 7.8 from adversely affecting existing transmission rights. Moreover, the simultaneous feasibility requirement imposed on the Incremental ARR option prevents existing transmission customers from subsidizing ineffective network upgrades under section 7.8. Additionally, PJM stated in its October 11 answer that section 7.8 is consistent with guideline (3) of the Final Rule, which plainly requires feasibility in LTTRs that are based upon network upgrades.

Commission Determination

46. We find that the PJM LTTR complies with guideline (3) of the Final Rule. The guideline, as written, clearly states that incremental rights awarded by directly funded upgrades must be feasible. We agree with PJM that if requests were granted that cannot be supported by the capacity of the system, the market would be undermined since they could not be financially supported by congestion costs and inequities would occur among market participants. We also note that the Final Rule states that parties that fund directly assigned upgrades are not entitled to rights to existing transmission capacity that is held by others.³²

47. With respect to incremental ARRs associated with network upgrades, we will reserve making findings on this aspect of the LTTR proposal. In its transmittal letter, PJM states that the implementation of section 7.8, "Elective Upgrade Auction Revenue Rights," will require the establishment of additional processes, rights and obligations to effectuate the rights authorized pursuant to that section. Additionally, PJM explains that it intends to develop a standardized process to support the granting of incremental ARRs so that such rights are transparent and clearly defined for participants. PJM also explains

³¹ PJM Answer to Compliance Filing Protests at 17.

³² Final Rule at P 215.

that it has initiated internal discussions to address these issues and intends to move forward in the stakeholder process with a proposal that standardizes the relevant processes as soon as possible. Further, PJM notes that it expects the schedule to develop the section 7.8 implementation rules will be consistent with the time of this filing. Given that one of the Commission's goals in Open Access Transmission Tariff (OATT) Reform is to provide greater transparency for transmission customers, we will review the schedule mentioned that clearly explains the process to support granting of incremental ARRs when PJM files those changes pursuant to section 205 of the FPA. We direct PJM to file these changes at least 60 days prior to the beginning of the next planning year, i.e. June 1, 2007, and to file status reports every 60 days (for informational purposes) from the date of this order until the tariff revisions are filed.

Guideline (4)

Long-term firm transmission rights must be made available with term lengths (and/or rights to renewal) that are sufficient to meet the needs of load serving entities to hedge long-term power supply arrangements made or planned to satisfy a service obligation. The length of term of renewals may be different from the original term. Transmission organizations may propose rules specifying the length of terms and use of renewal rights to provide long-term coverage, but must be able to offer firm coverage for at least a 10-year period.

48. The Commission stated that it will allow regional flexibility in defining the terms of long-term transmission rights that are offered and will permit substantial latitude to determine how to achieve long-term coverage through combinations of transmission rights of specific terms and renewal rights along with transmission planning and expansion procedures that support long-term rights. However, the Final Rule requires that transmission organizations make available transmission rights and renewal rights that provide coverage for a period of at least 10 years in order that transmission rights are offered that meet the reasonable needs of LSEs to obtain transmission service for long-term power supply arrangements used to meet service obligations while allowing transmission organizations and their stakeholders flexibility in designing rights that suit regional needs.

PJM LTTR Proposal

49. PJM states that the LTTR proposal establishes a 10-year long-term transmission right in compliance with guideline 4 in the stage 1A ARRs allocation that is established by section 7.4.2(b) of the proposal. These rights rollover on an annual basis through the 10-year term, thereby providing continuation of the rights for the eligible entities that elect to maintain them in stage 1A. PJM states that the rights are protected whether or not the holder nominates them each year because PJM conducts the simultaneous feasibility test as if all rights were nominated and plans accordingly. In addition, PJM

states that the proposal provides the opportunity to obtain 30-year incremental ARR. The stage 1A ARRs and the 30-year incremental ARRs are reasonably preserved for the term of the rights by incorporating them into the transmission planning process such that the planning process results in upgrades required to maintain the feasibility of such rights.

Comments

50. Chambersburg states that there are no assurances that long-term ARRs will be available or that ARRs will remain simultaneously feasible for the 10-year period due to their proximity to a congested line (Bedington-Black Oak). Chambersburg states that LSEs cannot be provided certainty if ARRs are not firm beyond one year.

PJM Answer

51. PJM states that Chambersburg's protest is essentially the same as that related to the full funding provisions. PJM states that while it is possible stage 1A ARRs could be pro-rated as a result of the feasibility study, the link to the transmission planning process mitigates this potential situation. Therefore, stage 1A ensures the long-term hedge requirements of the Final Rule by imposing limits on the amount of long-term rights made available in accordance with guideline (5).

Commission Determination

52. We find that the PJM LTTR proposal satisfactorily meets the requirements of guideline (4) by providing long-term rights of at least 10-years. The LTTR proposal also provides annual rollover protection to meet the renewal requirements of the Final Rule. The Final Rule does not prescribe specific rollover, or renewal, requirements for transmission organizations; but, by allowing for regional flexibility, the Final Rule requires that "transmission organizations [must] make available transmission rights and renewal rights that provide coverage for a period of at least 10 years."³³ Under the Final Rule, regional flexibility will allow stakeholders to harmonize the long-term rights and transmission planning, and with respect to rollover protection, the Final Rule stated that "renewal rights may be subject to provisions, such as adequate notice, that address the transmission organization's planning needs and adequate hedging of the LSE's long-term power supply arrangements."³⁴ In addition, the link to transmission planning and feasibility as discussed earlier helps to ensure that long-term ARRs will be available. For these reasons, the Commission finds that PJM's proposal is consistent with the Final Rule.

³³ Final Rule at P 258.

³⁴ *Id.*

Guideline (5)

Load-serving entities must have priority over non-load serving entities in the allocation of long-term firm transmission rights that are supported by existing transmission capacity. The transmission organization may propose reasonable limits on the amount of existing transmission capacity used to support long-term firm transmission rights.

53. Guideline (5) deals with the protection of transmission rights used to satisfy native load service obligations. In the Final Rule, the Commission found that both LSEs with long-term power supply arrangements and LSEs that prefer short-term power supply arrangements should receive the same preference for LTTRs, and that this preference is not shared with non-LSEs. The Commission concluded that this preference is supported by EAct 2005 and is effective in meeting the needs of the organized electricity markets.

54. Recognizing the reality that transmission capacity is limited, and that the amount of capacity that can reasonably be made available for long-term transmission rights may be lesser still, the Final Rule provided preference for LSEs to obtain long-term firm transmission service, and that this preference serves as a tiebreaker between LSEs and non-LSEs when the transmission system is limited.

55. The Final Rule also states that the transmission organization and its stakeholders should be given flexibility to determine the level at which an LSE may nominate long-term firm transmission rights as long as that level does not fall below the reasonable needs of the LSE. The Commission provided for transmission organizations to propose reasonable limits on the amount of transmission capacity made available for long-term rights citing that this level can be expressed as a straightforward measure of load, such as minimum daily peak load or 50 percent of maximum daily peak load, for example. The Final Rule also provides the transmission organization and its stakeholders with flexibility to propose an approach for incorporating load growth in the allocation process.

PJM LTTR Proposal

56. PJM states that the LTTR proposal imposes a Zonal Base Load limit on the amount of transmission system capacity available for LTTR. The standard is based on the lowest daily peak load during the 365-day period from October 31 of one calendar year to the same day in the subsequent calendar year. PJM states that the application of this standard effectively results in a quantitative limit equal to approximately 60 percent of an LSE's peak load. Further, PJM states that the proposal includes a LTTR priority allocation in favor of transmission customers that serve historical native load in the PJM region. According to PJM, the stage 1A priority maintained by the LTTR proposal inures to LSEs that serve historical native load in the PJM region that paid the costs of the embedded transmission system used to serve that historical native load.

Comments

57. NRG states that PJM's definition of Zonal Base Load may not be sufficient for the appropriate level of long-term procurement without an explanation of why a single day should set the baseline, rather than, for example, the median peak for the calendar year. NRG finds that establishing criteria that rely on a single day anomaly to establish the baseline to determine whether new resources would be eligible for LTTR appears arbitrary and is without support.

58. Allegheny asserts that under the proposed definition of Zonal Base Load, LSEs will not be entitled to obtain long-term transmission rights on behalf of their native load customers necessary to deliver historical generation resources to those customers. Allegheny states that the LTTR proposal fails to meet the requirements of section 1223 of the 2005, because it does not adequately preserve the transmission rights of native load customers that Congress intended to protect, and the Commission must ensure that these rights are protected in PJM's move to long-term allocations of transmission rights. Allegheny proposes an alternative definition to Zonal Base Load. Allegheny proposes that Zonal Base Load be defined as the greater of PJM's definition of the lowest daily zonal peak load over the preceding twelve months, or the Network Service Peak Load allocation for (a) 2003, or (b) the year of integration into PJM if later than 2003.³⁵ The Maryland Municipalities agree that the Zonal Base Load methodology does not do enough to ensure that native load customers' historic transmission rights are protected, adding that the minimum peak load would typically represent 40-50 percent of the annual peak load.

59. Constellation is concerned that PJM's LTTR proposal provides unwarranted, preferential treatment to franchised, vertically integrated market participants from regions that are not open to competition at the expense of those market participants in areas that are embracing wholesale and retail competition. If the Commission accepts the LTTR proposal, Constellation believes it should require PJM to file, by a date certain, an amendment to the LTTR proposal that will accommodate the participation of wholesale suppliers in provider of last resort competitive procurement processes. Under such wholesale competitive procurement processes that are utilized in a number of PJM states, FTR products should have multi-year terms of two and three years (or longer, if such programs are extended for longer periods). Furthermore, if the instant filing is accepted, Constellation states that the Commission should require removal of certain tendered tariff language to ensure the preservation, to the extent possible, of existing ARR allocations regardless of changes in rules, regulations or laws.

³⁵ Allegheny protest at 8.

60. LIPA states that the PJM LTTR proposal would effectively preclude LIPA and other similarly-situated LSEs that hold long-term transmission rights and pay the embedded costs of the PJM grid from obtaining LTTRs unless they fund, on a prospective basis, upgrades to the PJM system. According to LIPA, this effectively limits LTTRs from existing capacity to those entities that are transmission-owning members of PJM, and to exclude LSEs—even those that purchase long-term firm transmission on the PJM grid—that serve load outside of the PJM region. LIPA states that many entities other than the incumbent PJM transmission owners pay the embedded costs of the PJM system. LIPA also asserts that the stage 1A ARR methodology is inconsistent with PJM’s treatment of the cost allocation methodology for Regional Transmission Expansion Plan (RTEP) Upgrades,³⁶ under which all PJM transmission customers “are paying for the embedded costs of the system.”³⁷

61. LIPA states that the proposal to limit LTTR allocations to entities holding firm rights as of an historical reference year of 1998 contravenes the Commission’s Final Rule. According to LIPA, excluding a market participant from LTTR allocations because the party was not taking firm PJM transmission service in 1998 is fundamentally discriminatory and unreasonable. Through its payment of the PJM Border Rate,³⁸ LIPA believes that it pays its fair share of the embedded PJM system costs. If LIPA is to be treated equally to other internal PJM load for the purposes of allocating transmission upgrade costs incurred through the RTEP, and otherwise is to pay for the embedded cost of the system it uses through the PJM Border Rate, it argues that it should be treated similarly with respect to the allocation of LTTRs.

62. The Maryland Municipalities state that the PJM LTTR proposal is inconsistent with EAct 2005 and the Final Rule because it incorporates the current ARR pro-ration methodology, pursuant to which the Maryland Municipalities received only 44 percent of their nominated stage 1 historic ARRs, and 41 percent of ARRs nominated in stage 2. The Maryland Municipalities anticipate that these types of reductions will continue under the LTTR proposal, stating that the proposed definition of the level of ARRs to be included in LTTR stage 1A based on Zonal Base Load, is not sufficient to support the Maryland Municipalities’ existing native load transmission rights on the transmission

³⁶ According to PJM, RTEP projects create incremental transmission rights that are allocated pursuant to the Tariff. PJM Answer to compliance filing protests at 13, n.33.

³⁷ LIPA comments on PJM compliance filing at 2-3.

³⁸ The PJM Border Rate is not defined by the PJM Tariff, but it is the charge for points of delivery at the border of PJM.

system that they have paid to support. The simultaneous feasibility pro-ration that resulted in significant reductions in the Maryland Municipalities' ARR will continue in the LTTR proposal.

63. The Maryland Municipalities support an alternative in which the stage 1A allocation would not be subject to pro-ration. In the event that not all ARRs nominated in stage 1 were simultaneously feasible, there would be an uplift charge to be collected from all PJM transmission users to ensure that the ARRs met the Commission's mandate that they be fully funded. In such a scenario, stage 1B also would be modified to give LSEs an entitlement to receive ARRs so they would be fully hedged without pro-ration. The Municipalities state that if the Commission does not reject the proposal, or support the alternative proposal, the Commission should suspend the proposal for five months and set it for hearing.

64. Chambersburg states that the ARRs allocated to itself and other LSEs in the Allegheny Zone have been reduced by almost 50 percent, which has and will continue to cost them millions of dollars in additional costs, merely by virtue of their location near, and historical use of, the constrained Bedington-Black Oak line and PJM's application of its ARR pro-ration rule. Chambersburg states that this problem would be imported into, and continued by, PJM's Long-term ARR proposal. Chambersburg finds that the proposal does not provide long-term transmission rights, but rather a series of ten 1-year ARR allocations which can be pro-rated in any and all years during the ten-year period in the event that changes on the PJM system render not all of the ARRs simultaneously feasible.

65. Chambersburg believes, however, that reasonable limitations on the ability of PJM to pro-rate ARRs in stages 1A and 1B of the allocation process would eliminate the harm and make the PJM LTTR proposal just and reasonable. Chambersburg recommends that stage 1A not be subject to pro-ration. Similar to the Maryland Municipals, Chambersburg maintains that in the event that not all ARRs nominated in stage 1A were simultaneously feasible, there would be an uplift charge to be collected from all PJM transmission users. In stage 1B, Chambersburg states that an LSE would be entitled to receive ARRs up to the LSE's full energy requirements without pro-ration and any deficiency collected through uplift also. Chambersburg proposes that the full energy requirement would be defined as a percentage of peak load that will hedge a LSE for its requirement to meet its service obligations to its native load. The limitation would ensure that, if not all ARRs were simultaneously feasible, a LSE in stage 1B would get ARRs necessary to hedge its full energy requirements, but not more than that amount.

66. Allegheny adds that as a result of the way PJM models loop flow in its ARR and FTR allocation process, transmission customers in the Allegheny Power transmission zone of PJM are forced to bear a disproportionate amount of the costs associated with the region-wide problem of loop flows in PJM. This occurs despite the fact that the

customers are not the cause of the loop flow at issue. Allegheny states that PJM's current transmission system planning model imputes loop flows to the system, thereby automatically reducing the amount of transmission capacity available for allocation as ARR and FTR. Allegheny states that a better approach would be to eliminate loop flows from PJM's simultaneous feasibility model in the first place, and allocate LTTRs based on known firm uses and physical limitations of the system.

PJM Answer

67. With respect to NRG's position that the LTTR proposal defines Zonal Base Load too conservatively, PJM points out that the use of Zonal Base Load as a limit on the amount of capacity available for LTTR is consistent with the LTTR Final Rule.³⁹ According to PJM, the Commission recognized that there are legitimate reasons that transmission organizations may need to limit the capacity made available to support LTTR, including load growth, changes in power flows and the position that LTTRs are principally needed to support base load requirements and not to support intermediate or peak load.⁴⁰ The use of Zonal Base Load is consistent with guideline (5), which authorizes the imposition of limits on capacity made available for LTTRs, provided the limits meet the reasonable needs of the LSEs. Although the Final Rule does not define reasonable needs, PJM cites discussion in the Final Rule to the effect that LTTR capacity limits could be established in a variety of ways, including minimum peak daily load or fifty percent of maximum daily peak load. PJM asserts that its use of Zonal Base Load is consistent with this guidance provided in the Final Rule and the guideline (5) reasonable needs standard.

68. In response to Allegheny's argument that its proposal does not preserve native load preference, PJM counters that its LTTR proposal preserves the native load priority for the entire set of transmission rights that existed at the time the relevant transmission zones integrated into the PJM region. The fact that the priority allocation in stage 1A limits LTTRs to the Zonal Base Load does not diminish the priority that this native load receives. Rather, PJM asserts that this limitation imposes an authorized limit on a particular subset of priority rights. Native load still retains its priority access to all sets of transmission rights, not just the stage 1A ARRs. Moreover, the PJM planning process incorporates prospective consideration of the need for transmission upgrades. That is, to ensure the viability of the stage 1A ARRs for the 10-year term, the feasibility of the rights over the entire term is incorporated into the transmission planning process. If the feasibility of LTTRs is at risk in any future year, PJM asserts that it will implement transmission upgrades to remove this risk.

³⁹ See PJM's Zonal Base Load definition, 4 n.2 *supra*.

⁴⁰ *Id.*, citing Final Rule at P 323.

69. PJM takes issue with the allegations that the LTTR proposal violates guideline (5) of the Final Rule. For example, PJM disagrees with Constellation's concern that the LTTR proposal is inconsistent with retail competition because it gives preferential treatment to franchised, vertically integrated market participants from states that are not open to competition at the expense of market participants in retail access states. According to PJM, the stage 1A ARR transfers from one LSE to another if the load migrates during the term of the rights, which ensures that the LTTR proposal does not create a barrier to competition. Likewise, the hedge moves with the load so that one supplier does not maintain an unfair advantage in the market place and competitive suppliers can compete on price without regard to the impact of the LTTR hedge. However, if the competitive supplier is the transmission customer under the PJM Tariff, then it would receive the stage 1A ARRs directly, which it could convert to FTRs each year of the relevant term or it could keep the ARRs and use the revenues to purchase alternative FTR hedges or to offset congestion charges. According to PJM, under the state retail program, if the incumbent provider remains the PJM transmission customer, the procurement process can require that the incumbent provider assign those rights to the winning suppliers in the state retail procurement process and/or exercise such right at the direction of the winning suppliers, effectively achieving the same results as if the competitive supplier were the transmission customer. Thus, PJM argues that the LTTR proposal is consistent with the guideline (5) priority for LSEs in the allocation of LTTRs and thus will not discourage or act to the detriment of retail competition.⁴¹

70. PJM also disagrees with LIPA's assertion that the LTTR proposal unduly discriminates against market participants that are not PJM transmission owners. PJM acknowledges that the stage 1A ARRs are only available to Network Service Users and Qualifying Transmission Customers. However, PJM asserts that this priority is consistent with the priority mandate of the Final Rule, because both classes of transmission customers that receive the priority allocation under the LTTR proposal fall within the definition of LSE in the Final Rule. PJM asserts that guideline (5) creates a preference for LSEs over non-LSEs; and among LSEs, those with load serving obligations within a transmission organization's service territory receive a higher priority than LSEs with service obligations outside that region.⁴² Thus, PJM concludes that "because priority inures to the benefit of historical native load in the PJM region, transmission customers/LSEs such [as] LIPA, that are neither historical, nor serving load in the PJM region, are not eligible for the priority."⁴³

⁴¹ *Id.* at 18.

⁴² PJM Answer at 12, *citing* the Final Rule at PP 318, 325 and 328.

⁴³ *Id.* at 13.

71. PJM also disagrees with LIPA's assertion that the LTTR proposal violates guideline (5) because of inequities that allegedly arise from the different treatment of transmission customers in the LTTR priority and RTEP cost allocations. PJM states that LIPA is incorrect in asserting that these differences will be exacerbated because entities such as LIPA will be required to pay for RTEP upgrades implemented specifically to preserve the feasibility of stage 1A ARR's even though those upgrades will only benefit the priority holders of stage 1A ARR's. Under the LTTR proposal, only the beneficiaries of the RTEP upgrades implemented to ensure the feasibility of stage 1A ARR's will bear the cost of those upgrades.⁴⁴

72. PJM rejects LIPA's call for the elimination of the reference year limitation, pointing out that this reflects an historic delivery pattern whereby the transmission customer has already paid and continues to pay for priority allocation of existing transmission rights. According to PJM, the parties that receive the priority allocations paid for those rights prior to joining PJM, and the parties that elect to obtain LTTRs under proposed section 7.8 will pay for those rights by funding the necessary network upgrades.

73. PJM asserts that the pro-ration methodology itself is not an issue in this proceeding, but it acknowledges the relationship between how that mechanism may be applied to the new stage 1A ARR's and guideline (2) of the Final Rule. This guideline imposes a "full funding" requirement that the amount and value of LTTRs, once allocated, be fixed for the term of the right. According to PJM, its proposal satisfies this requirement by linking the feasibility of stage 1A ARR's, which have first priority, to the transmission planning process, which is intended to ensure that there should be adequate transmission capacity to support the viability of the ARR's in terms of amount and funding.

74. In its October 11 answer to the protests of its informational compliance filing, PJM disagrees with the Maryland Municipalities' assertions that the LTTR proposal is inconsistent with section 217 of the FPA and the Final Rule. PJM states that section 217(b)(4) requires that LTTRs be made available to meet the "reasonable needs" of LSEs. The Final Rule interpreted this provision to require transmission organizations to make LTTRs available on a priority basis, but allowing for limits on the amount of such rights made available. Thus, PJM asserts that section 217 and the Final Rule do not require it to make LTTRs available in amounts to meet all of an LSE's load obligations, and its limitation of stage 1A ARR's to the Zonal Base Load methodology is consistent with the "reasonable needs" requirement of section 217 and the Final Rule.

⁴⁴ PJM Answer to Compliance Protests at 14.

75. With respect to the proposal to preclude pro-rationing of stage 1A allocations, which was proposed by the Maryland Municipalities and by Chambersburg,⁴⁵ PJM states that “the matter, in essence, represents a policy determination for the Commission to decide in light of the ‘reasonable needs’ standard expressed by Congress.”⁴⁶ PJM opposes the Maryland Municipalities’ request that the Commission suspend the LTTR proposal for the maximum period and establish hearing procedures, stating that suspension and hearings are unnecessary. PJM asserts that there are no issues of material fact in dispute. PJM argues that a hearing is unnecessary because opposition to the LTTR proposal is of a policy nature, and does not involve issues of fact.

76. PJM agrees with Chambersburg that the LTTR proposal would subject stage 1A ARR to a requirement that they be simultaneously feasible and that this could, in turn, result in pro-rationing under extreme situations. However, PJM asserts that the LTTR proposal effectively mitigates the potential for pro-ration by linking the feasibility of ARRs to the transmission planning process. According to PJM, this should ensure that there is always adequate transmission capacity in place to support the quantity and funding of the stage 1A ARRs and to provide the long-term hedge required by section 217(b)(4) and the Final Rule. PJM asserts that Chambersburg’s concerns reflect a basic misunderstanding of what section 217 requires, because Chambersburg believes that LSEs are entitled to a sufficient quantity of LTTRs to serve their peak loads. PJM states that section 217 requires only that transmission organizations provide LTTRs to meet the reasonable needs of LSEs. According to PJM, the Final Rule interpreted the reasonable needs requirement to authorize limitations on the amount of transmission capacity made available for LTTR allocations, and its Zonal Base Load limitation provides for LSEs’ reasonable needs.

77. Finally, PJM disagrees with Allegheny’s concern about the manner in which loop flows are modeled in the ARR and FTR allocation process. PJM asserts that Allegheny’s concern is with the existing ARR methodology that has been approved by the Commission already and is not a part of the LTTR proposal. Thus, this issue is beyond the scope of this proceeding, according to PJM. In addition, while acknowledging that the incidence of loop flows is not insignificant, it was not the principal factor underlying the pro-ration of certain ARRs in the 2006/2007 planning year. Rather, a more fundamental factor was the lack of physical transmission capacity over specific constrained facilities. PJM points out that activity is now underway as PJM and its stakeholders actively explore steps to mitigate the incidence of loop flows in these

⁴⁵ Chambersburg would also partially restrict pro-rationing of stage 1B allocations.

⁴⁶ PJM Answer at 5.

specific areas and that this should ameliorate the ARR pro-ration issue.⁴⁷ Thus, PJM requests the Commission to look beyond the loop flow issue as it considers the substantive aspects of the LTTR proposal.

Commission Determination

78. While the Commission finds that the PJM definition of Zonal Base Load is consistent with the requirements of the Final Rule in setting a reasonable needs standard for LSEs, we find that PJM has not met its burden under section 205 of the FPA that the stage 1A allocation process is consistent with the requirements contained in the Final Rule to ensure that LSEs receive sufficient priority for historical load should ARRs not be feasible.

79. The Final Rule concluded that “the transmission organization and its stakeholders should be given the flexibility to determine the level at which a LSE may nominate long-term firm transmission rights as long as that level does not fall below the reasonable needs of the LSE” and cites minimum peak daily load as a possible method of establishing LTTR capacity limits. Since PJM’s proposed term Zonal Base Load is based on the concept of a minimum peak daily load, the Commission rejects NRG’s assertion that Zonal Base Load is arbitrary. As PJM points out, the Final Rule did not guarantee that LSEs are entitled to receive LTTRs for the full amount of peak load and recognized that LTTRs may have to be limited in certain transmission organizations. Further, the Commission agrees with PJM that while the definition of Zonal Base Load limits the amount of LTTR capacity available, it does not impact the priority given to LSEs load for those rights. The LTTR proposal retains the historical load priority for all transmission rights, including the newly created long-term transmission rights product. Thus, Allegheny’s argument is without merit.

80. However, the Commission is concerned about whether PJM’s application of its existing simultaneous feasibility’s pro-ration methodology to stage 1A of its ARR allocation is consistent with the Final Rule and FPA section 217. As explained by the Maryland Municipalities and Chambersburg, when PJM determines that all requested ARRs are not simultaneously feasible, PJM’s existing pro-rationing methodology limits the amount of congestion hedges that can be allocated to certain transmission customers, due primarily to the proximity of their loads to the constrained facilities. This may result in certain LSEs in close proximity to a constrained facility being pro-rated more severely than more distant loads that produce flow on the constraint. For example, application of PJM’s pro-rationing methodology in the 2006/2007 planning year allocation resulted in the Maryland Municipalities receiving only 44 percent and Chambersburg receiving only

⁴⁷ PJM Answer at 23.

50 percent of their nominated stage 1 ARR. ⁴⁸ The Commission is concerned that this result may not provide adequate protection for certain LSE's historical service obligation as required by Order No. 681. An explanation of PJM's simultaneous feasibility test and pro-rationing methodology follows.

81. PJM uses a simultaneous feasibility test to ensure that the congestion payments due to awarded ARRs and FTRs can be funded from the congestion payments created in the energy market. This methodology effectively amounts to awarding ARRs and FTRs up to the physical capacity of the system. In fact, Schedule 1 section 7.5 of the PJM Operating Agreement states, in part, that "the goal of the simultaneous feasibility determination will be to ensure that there are sufficient revenues from transmission congestion charges to satisfy all FTR obligations for the auction period under expected conditions and to ensure that there are sufficient revenues from the annual FTR auction to satisfy all ARR obligations."⁴⁹ In other words, when system conditions reflect that ARRs or FTRs are not simultaneously feasible (i.e., not revenue sufficient), PJM must employ the pro-ration methodology in order to ensure payment of congestion credits. Should PJM determine that an ARR or FTR is not simultaneously feasible, it is required by the Tariff and Operating Agreement to pro-rate regardless of cause.

82. PJM employs a pro-ration methodology that results in reducing ARR and FTR allocations in proportion to the megawatts nominated and also in inverse proportion to effect of the nominations on a constraint. The PJM Tariff currently states:

All Auction Revenue Rights must be simultaneously feasible. If all Auction Revenue Right requests made during the annual allocation process are not feasible then Auction Revenue Rights are pro-rated and allocated in

⁴⁸ We note that in 2006/2007 annual ARR allocation process, Chambersburg nominated 54.1 MW of ARRs and was awarded only 28.8, or approximately 53 percent of its nomination level. Additionally, Front Royal, Virginia requested 36.6 MW and it was awarded only 19.9 MW, or approximately 54 percent of its nomination level. Further, the Maryland Municipalities state that they were awarded approximately 44 percent of their stage 1 nominated ARRs. During stage 2, they were able to obtain an additional 41 percent. However, the stage 2 paths were likely counter-flow paths that may require the Maryland Municipalities to face potentially higher congestion costs.

⁴⁹ See section 7.5 in Attachment K of PJM's Tariff has a corresponding provision.

proportion to the MW level requested and in inverse proportion to the effect on the binding constraint.⁵⁰

83. The market rules apply to all customers nominating ARR or FTR under the PJM Tariff and Operating Agreement in the stage that is pro-rated. These provisions were accepted by the Commission in 2004.⁵¹

84. Under the pro-ration methodology, those requests having the greatest impact on the operating constraint that is limiting ARR or FTR allocation are pro-rated by the highest percentage. PJM acknowledges that those entities causing the greatest flows on the constraint in proportion to their load will have proportionally more of their ARRs pro-rated than more distant loads that produce flow on the constraint. In other words, LSEs that have historically relied upon a congested transmission facility to meet their service obligations will be pro-rated, and exposed to transmission congestion costs to a greater degree than customers that are less dependent on the congested facility in order to satisfy their load obligations.

85. According to PJM the intent of the two-stage allocation process is both to protect native load expectations and to increase market flexibility. The historic reference year provides a snapshot of resources at the start of PJM market operations for each zone and the first stage gives customers priority in requesting ARRs from resources that historically served load in the transmission zone. At the same time, the second stage provides flexibility for customers to pursue hedging strategies that meet their changing needs.

86. The flexibility provided by the current PJM market rules allows entities with historical load to change their ARR requests from year to year, as long as such requests reflect historical loads and resources. This allows LSEs to change their hedging patterns and request more ARRs over constrained lines for reasons other than to preserve ARRs for historical load-to-resource paths. For example some entities may pursue a strategy

⁵⁰ See section 7.4.2(f) in Attachment K of the PJM Tariff and a corresponding provision in section 7.4.2(f) in Schedule 1 of the Operating Agreement. See also section 5.2.2 (f)(i) in Schedule 1 of the PJM Operating Agreement and a corresponding provision in section 5.2.2 (f)(i) in Attachment K of the PJM Tariff regarding the identical pro-ration methodology used for FTRs.

⁵¹ See *PJM Interconnection, L.L.C.*, 106 FERC ¶ 61,049 (2004), at P 39 (January 28 Order). See also *PJM Interconnection, L.L.C.*, 102 FERC ¶ 61,276 (2003) at P 34. The illustration is also provided in PJM Manual 06, *Financial Transmission Rights* available at www.pjm.com/contributions/pjm-manuals/manuals.html pages 25-26.

that will maximize the value of their ARR, by requesting ARRs over constrained facilities rather than over alternative paths. The Commission questions whether permitting this strategy may obstruct the ability to meet the Final Rule requirements of the stage 1A allocation. When ARR nominations are not simultaneously feasible, this strategy, together with PJM's pro-rationing methodology, may result in certain LSEs, i.e., those that are highly dependent on the constrained path, being pro-rated to such an extent that they may not be allocated sufficient firm long-term transmission rights to meet their reasonable needs—defined at Zonal Base Load. Further, under the pro-ration methodology currently in use and proposed to be carried forward to the LTTR market, certain LSEs that have historically relied upon a transmission facility to serve load, may be pro-rated to a greater degree than customers that require proportionately less use of the constrained path in comparison to their load (even if they use more of the constrained path in absolute terms). This holds true regardless of the LSE's contribution to the factors causing the limiting constraint, *e.g.*, increased nominations caused by LSEs changing their hedging strategies, load growth, and external loop flows. The Commission is especially concerned with this outcome with regard to loop flow because it appears to place a greater burden of unscheduled loop flows on the participants that are highly dependent on the congested facility compared with those that are less dependent on the facility (even though less dependent LSEs may have a greater megawatt flow over the facility). Since neither party is any more or less responsible for these flows it would appear to the Commission that the cost of loop flows should be allocated on a different basis (the general issue of modeling loop flow is addressed below).

87. For these reasons, the Commission finds that PJM has not met its burden of proof pursuant to section 205 of the FPA and we find that the proposed stage 1 allocation method may not be consistent with Order No. 681 and may produce a result that has not been found to be just and reasonable and may be unjust and unreasonable. This does not mean that we agree with the Maryland Municipalities and Chambersburg that PJM should establish an uplift charge collected from all PJM users to ensure that the municipalities receive a full congestion cost hedge. While we are concerned that PJM may not have provided sufficient priority for historical load, we recognize that it is appropriate to consider simultaneous feasibility and that pro-rationing may be necessary in some cases. However we find that the pro-ration methodology, as carried forward from the current market, may violate the Final Rule by subjecting LSEs to pro-ration below their Zonal Base Load in a manner that may not be equitable among all participants. In order for PJM to get the LTTR market up and running prior to March 1, 2007 as requested, the Commission directs PJM, together with its stakeholders, to examine the interaction of the flexibility allowed for ARR nominations and its pro-ration methodology on the ability of all LSEs to obtain sufficient long-term transmission rights (in stage 1A) to meet the reasonable needs of all LSEs taking service under the PJM OATT and Operating Agreement consistent with Order No. 681. In addition, consistent with the underlying objective to provide LSEs' priority to transmission rights on historical resources that will allow them to reasonably meet their load obligations, we expect PJM to examine the

interaction of the flexibility allowed for ARR nominations and its pro-ration methodology on the ability of all LSEs to obtain sufficient transmission rights in stage 1B and make appropriate revisions as necessary, or provide a detailed explanation for why changes are not appropriate.

88. To facilitate this process the Commission will make available a settlement judge and direct that proposed modifications to the proposed market rules be submitted to the Commission no later than 60-days from the date of this order. Pursuant to Rule 603⁵² of the Commission's Rules of Practice and Procedure, the Commission directs the Chief Administrative Law Judge to appoint a settlement judge to consider modifications to address the Commission's concerns with PJM's proposed stage 1 allocation method. If the parties desire, they may, by mutual agreement, request a specific judge as a settlement judge in the proceeding; otherwise the Chief Judge will select a judge for this purpose.⁵³ Alternatively, the parties may also make use of the Commission's Dispute Resolution Services.⁵⁴

89. PJM is directed to file with the Commission any amendments to its market rules that may be necessary to ensure that all LSEs that serve load within PJM's service area are able to obtain a reasonable amount of firm long-term transmission rights to meet their service obligations when all ARR requests are not simultaneously feasible. Any revised market rules are to be effective for the 2007/2008 PJM planning period.

90. Parties to this proceeding raised concerns regarding the treatment of external loop flow in the simultaneous feasibility analysis. We find that failure to model these flows, as suggested by parties, would violate guideline (2). However, PJM states that it is investigating the issue of unscheduled loop flow using its stakeholder process mechanisms (e.g., PJM established a Circulation Working Group) with the intent of mitigating the problem on a prospective basis.⁵⁵ Additionally, in the 2005 State of the

⁵² 18 C.F.R. § 385.603(c) (1) (2005).

⁵³ If the parties decide to request a specific judge, they should make their request to the Chief Judge by telephone at 202-502-8500 as quickly as possible following the motion for appointment of a settlement judge. The Commission's website contains a listing of Commission judges and a summary of their background and experience (www.ferc.gov - click on Office of Administrative Law Judges).

⁵⁴ The Director of the Dispute Resolution Services is Richard L. Miles, who may be reached at 202-502-8702 or 1-877-FERC-ADR (1-877-337-2237).

⁵⁵ Loop flow is essentially an increase in unscheduled transmission flow.

Market Report, PJM stated that although its total scheduled and actual flows differed by about 4 percent in 2005, there were significant differences for individual interfaces.⁵⁶ For example, according to PJM, external loop flows contributed approximately 20 percent to the pro-ration experienced by Allegheny Power's customers on the Bedington-Black Oak transmission line for the 2006/2007 planning period. Given that external loop flows have had an adverse effect on the annual allocation process, and that PJM is investigating the matter, the Commission directs PJM to continue working with its Circulation Working Group and to develop a resolution to this issue within a reasonable time frame. The Commission will require PJM to file, for informational purposes only that does not require any Commission action, a report that details its plan to address the problem of external loop flows by March 31, 2007.

Guideline (6)

A long-term transmission right held by a load-serving entity to support a service obligation should be re-assignable to another entity that acquires that service obligation.

91. The Commission stated that guideline (6) is intended to comply with section 217(b)(3)(A) of the FPA which required transmission rights be transferable to successors ensuring that they follow migrating load. Noting that rules governing the reassignment of firm transmission rights that follow migrating load already exist, the Final Rule provides transmission organizations and stakeholders flexibility to determine the specific rules. The Final Rule states that this reassignment issue relates to transmission rights that are allocated preferentially to an LSE in accordance with guideline (5) and not to rights acquired by an LSE via auction or direct assignment of funding an upgrade.⁵⁷ Guideline (6) also stated that it allows for the trading of transmission rights.

PJM's LTTR Proposal

92. PJM states that the LTTR proposal is incorporated into the proposed transmission rights structure in the PJM Interchange Energy Market, whereby stage 1A ARRs are reassigned if load migrates from one Network Service User to another. An entity holding the rights is free to trade the rights provided that the rights always remain subject to being reassigned. PJM states that transmission rights purchased in FTR auctions or acquired as a result of participant funded upgrades are not subject to the reassignment provisions.

⁵⁶ See PJM's 2005 State of the Market Report at pages 33-34.

⁵⁷ Final Rule at P 357.

Comments

93. LIPA states that PJM must remove the reference year limitation and ensure that LSEs that take firm service on the PJM grid have access to the rights granted under FPA section 217(b)(4). LIPA states that the PJM proposal is silent on whether LTTRs are tradable, and, if so, what conditions govern the transferability of those rights. Thus, it is not clear whether a secondary market will be permitted to develop for the LTTRs allocated by PJM. The development of such a market is particularly important given the relatively small amount of existing capacity allocated to LTTRs by PJM. LIPA states that the Commission should require PJM to clarify that LTTRs will be tradable, and to ensure that any conditions on transferability do not impede the development of a secondary market for LTTRs in PJM.

PJM's Answer

94. PJM states that the LTTR proposal meets the requirements of guideline (6) by providing for reassignment to follow migrating load.⁵⁸ PJM points out that, while the Final Rule supports full tradability, this support is subject to the qualification that allocated rights should be subject to recall if the load migrates. PJM states that the LTTR proposal does not prohibit bilateral trading of stage 1A ARRs, but it does require reassignment of those rights if the load migrates thereby subjecting such transaction to this risk. PJM states that revising the proposed market to remove this risk would run contrary to the priority provided by section 217 of the FPA.

Commission Determination

95. We find that the PJM LTTR proposal is consistent with guideline (6) by permitting stage 1A ARRs to migrate with the load obligation to which they were assigned and that the priority given those rights by that historical load is retained. LIPA asserts that long-term transmission rights should be fully tradable, in order to ensure that they go to the market participants that value them most. The Final Rule states that “long-term firm transmission rights that the load serving entity obtains preferentially through an allocation process should be tradable only with the proviso that trades may be subject to recall if load migrates to another load serving entity.”⁵⁹ Therefore, while a secondary market may develop for long-term rights, PJM is correct in stating that anyone who may acquire these long-term rights takes on the risk that they are subject to recall. We note that this recall provision governs the long-term rights allocated in stage 1A and does not

⁵⁸ PJM Answer to Compliance Protests at 17-18.

⁵⁹ Final Rule at P 358.

apply to transmission rights awarded in the remainder of the PJM allocation process and thus such rights are not subject to this recall provision in the secondary market.

Guideline (7)

The initial allocation of the long-term firm transmission rights shall not require recipients to participate in an auction.

96. Guideline (7) does not preclude a transmission organization from using an auction to allocate long-term firm transmission rights; rather, it only precludes requiring an LSE to submit a winning bid in an auction in order to acquire long-term firm transmission rights. The Final Rule described a number of different methods for allocating LTTRs, including the ARR allocation procedure used by PJM, where each LSE may, at its option, convert its auction revenue rights directly into annual FTRs with identical sources and sinks. In this way, LSEs that are obligated to pay the embedded costs of the transmission system should be able to receive an equitable share of long-term firm transmission rights without having to submit a competitive bid for those rights.

PJM's LTTR Proposal

97. PJM states that in line with its existing approach, stage 1A ARRs are to be allocated on a first priority basis to the relevant transmission customers that pay the embedded cost of the transmission system, and the entities that receive these ARRs have the option to convert those rights to FTRs in each annual ARR allocation/FTR auction period. Such entities do not need to participate in an auction to receive these rights.

Comments

98. No comments were filed regarding this guideline.

Commission Determination

99. We find that the PJM LTTR proposal is in compliance with guideline (7) of the Final Rule. Under the PJM proposal, LSEs are not required to participate in an auction and therefore not required to submit a winning bid in order to receive long-term rights in stage 1A.

B. General Comments

1. Transmission Planning and Expansion

100. The Final Rule requires each transmission organization to implement a planning process that will accommodate the long-term rights that are awarded by ensuring that

they remain feasible over their entire term. The Commission stated that this is essential in order to meet the full funding requirement of guideline (2).⁶⁰ The Final Rule requires that each transmission organization to make its planning and expansion practices and procedures publicly available.

PJM's LTTR Proposal

101. PJM states that the guideline (2) simultaneous feasibility requirements for stage 1A ARR is incorporated into the transmission planning process in schedule 6 of the PJM Operating Agreement. PJM states that schedule 6 was modified to incorporate the feasibility of stage 1A ARRs and section 7.8 for incremental ARRs into the RTEP process as discussed in the response to guideline (2). PJM also states that the transmission planning practices and procedures are also publicly available with reports posted on the PJM website.

Comments

102. EPSA states that any LTTR program must be linked to the region's coordinated, long-term transmission planning process in order to ensure that all users have equal access to the system and so that the system is planned and expanded in a manner which preserves the feasibility of existing FTRs or ARRs, and accounts for any FTRs or ARRs associated with new resources or incremental (30-year) ARRs to be funded by requesters.

Commission Determination

103. We find that the PJM RTEP process meets the requirements of the Final Rule. The rules contained in schedule 6 of the PJM Operating Agreement and PJM Manuals that spell out the planning process and procedures are sufficiently public, as are the stakeholder meetings on the planning process and results held by PJM.

C. Other Issues

1. PJM Transmission Rate Design

Comments

104. Constellation is concerned that the significant departure from fully zonal, or license plate rates, to fully socialized, or postage stamp rates, as is under consideration in Docket No. EL05-121-000, should be resolved before the Commission makes a determination regarding the merits of PJM's proposal to lock-in the current ARR

⁶⁰ Final Rule at P 453.

allocation methodology for ten years. Constellation states that the proposed changes to transmission rates represent a radical shift in cost allocation (from zones to socialization), and as such, the ARR allocation methodology is in need of modification to preserve the hedging equities that ARRs were intended to provide for transmission customers.

PJM's Answer

105. PJM replies that, while it does not necessarily disagree with Constellation's concern about the effect of a change in rate design in Docket No. EL05-121-000 (the rate design proceeding) on the proposed ARR allocation process, it asserts that this issue should be addressed in another forum once the outcome in the rate design proceeding is final. "Modifications to the LTTR proposal, if necessary, will be considered once a final order issues in EL05-121."⁶¹ PJM argues that this issue is, therefore, beyond the scope of the instant proceeding and should be rejected. PJM also points out that section 7.4.2(b) of the LTTR proposal is, in effect, a "savings clause" that allows for a reasonable transition period should there be a regulatory change that could affect ARR and FTR allocations. Finally, PJM states that, because the outcome of the rate design proceeding cannot be predicted and could take years for a final determination, the Commission should not delay implementation of LTTRs in the PJM market "based on the potential outcome in a separate, unrelated proceeding."⁶²

Commission Determination

106. In an ongoing proceeding, Docket No. EL05-121-000, the Commission is currently examining the justness and reasonableness of continuing PJM's modified zonal rate design (commonly referred to as license plate rates) for transmission service in the entire PJM footprint. After PJM filed the LTTR proposal, an initial decision was issued in that proceeding concluding that a new rate design could be implemented, even if the allocation of ARR/FTRs had to be subsequently amended.⁶³ This decision is now before the Commission and a final order has not yet been issued. Certain parties in that proceeding have argued that transmission rate design is intricately tied to the allocation of FTRs/ARRs, and that a change in transmission rates must correspond to a change in the allocation process. However, we believe that ruling on the PJM LTTR proposal will not affect the transmission rate design proceeding, and that if the outcome of Docket No. EL05-121-000 involves modifying the ARR/FTR allocation process, such modifications can be addressed at the appropriate time.

⁶¹ PJM Answer at 15.

⁶² *Id.* at 16.

⁶³ See *PJM Interconnection, L.L.C.*, 116 FERC ¶ 63,007 (July 13, 2006).

2. PJM Capacity Market Design

Comments

107. NRG states that the objectives of PJM's LTTR proposal will only be fully realized if a viable capacity market with a meaningful forward commitment obligation is developed and implemented within PJM. NRG states under PJM's LTTR proposal, competitive generation suppliers' ability to obtain LTTR for new resources is dependent on long-term contracts with LSEs for both energy and capacity. Thus, NRG asserts, the LTTR proposal assumes a capacity market that fosters long-term contracts and sends accurate price signals that provide incentives for LSEs to enter into long-term contracts with third parties; such a capacity construct does not currently exist in PJM. For this reason, the viability of PJM's LTTR proposal is influenced, in large part, on the outcome of the Commission's consideration of PJM's Reliability Pricing Model (RPM).

PJM Answer

108. PJM disagrees with NRG's assertion that the outcome of the Commission's consideration of PJM's RPM will have significant influence on the viability of the LTTR proposal. Because the RPM is being addressed in the Docket No. ER05-1410-000 proceeding, PJM asserts that the design and operation of that model are beyond the scope of this proceeding and should not be considered by the Commission in its evaluation of the LTTR proposal.⁶⁴

Commission Determination

109. On April 20, 2006, the Commission issued an Initial Order in Docket No. ER06-1410-000 on the RPM, ruling that PJM's existing capacity construct was unjust and unreasonable, but could not find RPM to be a just and reasonable replacement because certain elements of the RPM proposal required further development.⁶⁵ The parties have been engaging in settlement negotiations before Judge Lawrence Brenner. Parties filed a settlement on September 29, 2006, requesting the Commission to act by December 22, 2006. The Commission understands NRG's concerns regarding PJM's capacity market. However, those concerns are being addressed in the RPM proceeding and are beyond the scope of this proceeding. The Commission therefore concludes that the implementation of PJM's LTTR product and ongoing modifications to PJM's capacity market are independent issues.

⁶⁴ PJM Answer at 5.

⁶⁵ *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079 (2006).

The Commission orders:

- (A) PJM's Proposed LTTR market rules are hereby approved except as discussed in the body of this order.
- (B) PJM is directed to file a mechanism to provide a source of revenues to make up for shortfalls in congestion revenues within 60 days from the date of this order.
- (C) PJM is directed to file market rules to support incremental ARR's at least 60 days prior to June 1, 2007, as well as periodic status reports, as discussed in the body of this order.
- (D) The Commission will institute settlement judge procedures to address its concerns with the stage 1 allocation process (i.e., both stage 1A and stage 1B), as discussed in the body of this order.
- (E) The Chief Administrative Law Judge is directed to appoint a settlement judge, as discussed in the body of this order.
- (F) PJM is directed to file with the Commission any proposed revisions to its market rules that may be necessary to ensure that all LSEs that serve load within PJM's market area are able to obtain a reasonable amount of LTTR to meet their service obligations when all ARR requests are not simultaneously feasible, as discussed in the body of this order.
- (G) PJM is directed to make an informational filing that provides a plan to resolve the issue of unscheduled loop flow as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.